



January 30, 2007

Ms. Jennifer J. Johnson
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

RE: Consultation Paper on Intraday Liquidity Management and Payment System Risk Policy –
Docket No. OP-1257

Dear Ms. Johnson:

Over the past two years, BNP Paribas (“BNPP”) has taken an active role with the Institute of International Bankers (IIB) to discuss intraday liquidity management and the associated payment system risk policies with both the Federal Reserve Bank of NY and the Federal Reserve Board of Washington, D.C. Our contention is that the present day Fedwire system has risk associated with the fact that a large portion of money transfers are held up in queue until late hours of each settlement day. If these transfers were executed through the system earlier in the day, the net effect would be increased liquidity and faster recycled liquidity. This domino effect of earlier transfers creating the ability for more early transfers would make the payment system more efficient and reduce the day-to-day settlement risk dramatically.

Institutions should be encouraged to clear their wire transfer queues as quickly as possible, ensuring a safer and sounder payment system. Again BNPP suggests that a reasonable starting point on quickening the pace of wire transfers would be to review the current daylight overdraft deductible calculations. BNPP feels this calculation should be constructed to encourage, rather than discourage, financial institutions to facilitate early wire transfers. BNPP believes the current calculations cause a competitive disadvantage to foreign banks as opposed to their American counterparts. BNPP hopes that this area will get particular attention paid to it during the total assessment of the payment system and its associated risks.

BNP Paribas feels honored to be able to participate in this process by commenting on potential solutions and is happy to answer the questions addressed in the consultation docket labeled OP-1257.

Questions (page 12/13)

1) What intraday liquidity conservation strategies and technologies does your institution use (such as controlling the timing of payments and introducing queuing techniques to conserve on liquidity)? How do these affect your institution’s timing for sending payments? What, if any, changes are you planning with regard to intraday liquidity management?

- BNPP routinely manages its intraday debit cap usage to a level which the value of the deductible will support while incurring the least possible daylight overdraft charges. We systematically curtail the allowable overdraft and manually control the payment flow to reduce the amount and duration of such overdrafts. Exceptions to this are made daily to accommodate time sensitive payments such as CLS and Central Bank Investment Payments where urgency dictates the need for overdrafts. Finally, understand that urgent payments may ultimately delay non-urgent or less time sensitive payments until later in the day.

2) How do the concentrated demands for intraday central bank money by private sector systems influence intraday liquidity management by depository institutions throughout the day? Are there significant concentrated sources of demand for intraday central bank money beyond those already mentioned in the text and how does this demand affect intraday liquidity management?

- BNPP reacts to intraday central bank money requests via a combination of automated and manual intervention to the internal payment system. This allows those specific payments to move up faster (or immediately) in the queue. This special payment prioritization by default would potentially slow down other non-priority payments which would have already been waiting in the queue.

3) Is the concentration of payments late in the day a concern for your organization? If so, what is the nature of your concern? Does it include operational risk from late-in-the-day payments, and has operational risk to your organization from such payments been increasing or decreasing? What are the key drivers of late-in-the-day payments? How has your organization responded to the late-in-the-day concentration of payments?

- The concentration of late day payments is very much a concern for BNPP. As stated earlier, BNPP views much of this as unnecessary and a result of the current incentives (or disincentives) for wiring funds earlier in the day. BNPP has observed that there are a disproportional amount of funds which are moved in the last hours of the business day, posing operational risk and credit risk to the financial system. While trend information is not readily available, we have sampled a month's worth of data (prior to an onsite-visit invitation of members of the FRB Washington Payment System Risk Division) to see if we could find information on system payments. During those sample days, an average of 43% of our Fedwire dollar volume came in after 5:00 PM. (*The range during the test period was between 13% and 64%*) Most of these late items were large volume tickets, since on average they accounted for less than 3% of the daily Fedwire ticket volume. If 3:00 PM is our point of reference, then 70% of our Fedwire dollar volume came in after that time, which was close to 30% of the Fedwire ticket volume. In addition to the late day bank-to-bank settlement transactions, there are three reasons for the late day, large dollar movements:

- First, banks release payments late in the day to minimize DLOD costs.
- Second, banks convert payments from CHIPS to Fedwire just prior to 5:00 to avoid the large CHIPS debit settlement positions.

- Third, resulting payments that banks can release as a consequence of receiving payments for their customers due to other banks late releases (their reactions to first and second point above).

BNPP has responded to the “late-in-the-day” concentrated payments as most other banks do. It maintains a larger staff specifically to monitor and manage what becomes a fast paced and potentially hurried settlement each day. BNPP also makes and receives additional inquiries to other institutions confirming the pending money movements.

4) For the market, operational, and PSR Policy changes discussed in this document and listed as follows, how might the timing of payments and the demand for daylight overdrafts be affected? What advantages or disadvantages do you see for these changes?

- BNPP believes many of the suggestions make theoretical sense, but feels some are less practical than others. Written responses to each are listed separately.

- A) An intraday market to exchange liquidity between institutions that hold positive balances at the Reserve Banks and those that run negative balances

- BNPP believes this option could require multiple settlements instead of the one end of day close. If so, BNPP does not support this concept. The current 6:30 PM daily settlement close works because all other markets are already closed for the day. Therefore, there are a limited number of surprises that can change an institution’s balance. During a normal day, staff responsibilities are usually shifted from approximately 5:00 PM until 6:30 PM. Operations personnel can focus all their efforts on an effective single system close. Multiple settlements would be near impossible as concentrated efforts as described above can not happen. In this case, the workload incurred by front and back offices during the settlement period (retrieving balance information and quickly reacting to it) is limited to the end of the day. Multiple settlements could require a large upgrade in IT and personnel investments to reduce the stress and strain on the funding areas of many institutions.

One potential negative outcome of multiple settlements could also be the slowing of payments throughout the day in shorter and more frequent “hold” queues. Multiple settlements might cause institutions to hold money in each time period until the last possible minute for each period. If so, the payment system would feel short bursts of large money movements along with quiet periods. This still may be better than today’s system, but probably not the improvement envisioned with multiple settlements.

- B) A market for the early return of federal funds or other money market investments

- BNPP supports the recommendation of early returns. Since federal funds return amounts are known in advance, there are few operational reasons to hold them up in queue beyond the normal proof that all proper payments were received the day prior.

It is likely that the delays of these return payments are a result of the management of daylight overdraft cost issues. An increased amount of late return payments are likely a result of some of the negative competitive advantages and inefficiencies in our current system. Also, some financial institutions might need wire infrastructure improvements, as many early returns require manual intervention. Some institutions might need to upgrade to time specific automatic queues, assuming no manual adjustments are made prior. This is one solution that is worth the investment, allowing the pace of liquidity throughout the system to quicken.

- C) Enhancements by private settlement systems that further economize on the use of central bank money, for example multiple settlement periods to release liquidity earlier in the day
 - BNPP does not support the concept of multiple settlements as stated earlier in this response. However, it should be noted that the IT infrastructure change, including wire code changes, would probably be quite expensive to achieve this as well.
- D) Liquidity saving mechanisms for the Fedwire funds transfer system
 - BNPP supports this concept as well although potential private IT system upgrades might be very costly.
- E) Throughput requirements for the Fedwire funds transfer system
 - BNPP supports this concept, but would need to further study the practical issues involved.
- F) Greater use of voluntary or required collateral to cover partially or fully daylight overdrafts in depository institution accounts at the Reserve Banks
 - BNPP supports this concept. Assuming the same collateral that is sitting in most banks' accounts already tagged for Discount Window borrowing purposes is available to use to facilitate daylight overdraft coverage, it is a very practical solution for all. Collateral management is already in place for most major participants, likely making the upgrade to this new system inexpensive to initiate. At first glance, it also is likely keep the playing field even for all.
- G) Two-tiered pricing for collateralized daylight overdrafts, with a fee charged for collateralized daylight overdrafts set lower than the rate for uncollateralized overdrafts
 - BNPP believes that this is also a good idea. It enhances the above point and again appears very practical.

- H) Time-of-day pricing of daylight overdrafts.

- BNPP supports this as a potentially good idea. However, it is hard to understand the ramifications of this pricing effect. The new pricing must encourage early use of the wire system to facilitate faster settlements. Therefore, an institution should be charged less to create an overdraft earlier in the day, hoping this will recycle liquidity faster. In today's world, charges are incurred for the period an institution is in an overdraft situation. To encourage less late day wire traffic, the length of time in overdraft would have to be offset by a lower charge for earlier payments. This might not be an easy system to devise, but we think it is a good idea if it can be devised correctly.

5) What are other possible approaches to consider to reduce delays in payments and to manage efficiently and effectively the Federal Reserve's exposure to increasing daylight overdrafts as well as depository institutions' exposure to intraday liquidity and credit risks? Are there other market or operational changes in the private sector that could help reduce intraday liquidity and credit risks?

- Most avenues are already mentioned or explored in your document or our response. One additional thought might be to have an extended time space between CHIPS close and Fedwire close to smooth the process a bit. This may not be practical as no one wants a later Fedwire close and I am not sure CHIPS could or would close earlier.

6) Congress is currently considering legislation that would allow the Federal Reserve to pay interest on reserve balances held by depository institutions at the Reserve Banks. How would the payment of interest on reserves affect depository institutions' intraday liquidity management, including the demand for daylight overdrafts at the Reserve Banks? Could the payment of interest on reserves be utilized to reduce the value or timing of daylight overdrafts?

- Although banks would benefit from interest earned on reserve bank balances, BNPP considers this idea as being bad for the system. The ramifications of interest earned on balances would likely drain liquidity from the system and slow down payments. Currently, banks are encouraged to manage their balances very closely, as idle balances have an opportunity cost for each institution. This makes each institution more likely to invest their excess cash and create liquidity for the system. This extra liquidity can be passed around more than once, expanding or recycling liquidity. If BNPP receives unexpected funds late in the day and is entitled to reserve interest, those funds might sit in BNPP's account earning that (even reduced) amount. This is excess money now taken away from the overall market system. However, if BNPP does not receive any return of interest on those funds, then every effort will be made to reinvest those funds back into the market. This enables a bank to receive those funds to cover its position or have the capacity to wire more funds outside its bank. It is this recycling of liquidity that should be encouraged in any reasonable way possible. This is what keeps the bank reserve system operating efficiently.

Please feel free to follow up on any of these issues or new issues with me. I will be more than happy to discuss them further. I can be reached at 212-841-2425.

Sincerely yours,

Jonathan Light

Head of U.S. ALM Treasury

BNP Paribas U.S.

cc: Everett Schenk, CEO, BNP Paribas North America

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